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SENSITIVE
SIPDIS

TREASURY FOR STEPHEN ALTHEIM AND REBECCA KLEIN
TREASURY PASS TO USED TO THE WORLD BANK
USAID FOR AA/AFR EGAST AND AFR/SD DATWOOD

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TAGS: [EAID](#) [ECON](#) [PREL](#) [PGOV](#) [ET](#)
SUBJECT: WORLD BANK PBS VOTE - SETTING BENCHMARKS AND REVIEW
REQUIREMENTS

REF: 2008 ADDIS 3462

This is an Action Request for Treasury and the USED to the World Bank. Please see para 2.

SUMMARY

11. (SBU) The World Bank's Protecting Basic Services (PBS) project has filled a gap in providing critical health and education services to rural Ethiopians while creating a limited window of significant transparency in illuminating budget allocation and expenditure data to the public. Still, three years after starting, the program continues to provide a "band-aid" approach covering recurrent costs which are unsustainable under the current macroeconomic framework. In the mean time, broader political space in country has narrowed dramatically. As currently designed, PBS II does not make continued funding contingent on actual policy progress. Setting benchmarks and having the World Bank's Board review progress made on needed macro-economic or political policy reforms will make PBS II a more effective mechanism for achieving sustainable development. End Summary.

ACTION REQUEST

12. (SBU) The Bank's internal deliberation on a PBS II project, and the Bank's Board of Directors' subsequent vote on the project, provide an opportunity for the United States to break the donor cycle of "business as usual" to hold the Ethiopian Government (GoE) accountable to provide a sufficiently conducive environment for democracy and development to merit sustained receipt of donor assistance. We recommend that Treasury and the USED to the Bank raise with the Bank's Operations Committee (OC) the requirement for annual or mid-term Bank Board review of the PBS II program. We recommend that the nearly \$600 million, three-year PBS II project be divided into three annual tranches (or at least two tranches reviewed at the mid-point) with each subjected to a new Board vote. This approach to the OC prior to its February 27 meeting to review PBS II would allow for revisions to the PBS II Project Appraisal Document (PAD) before the project goes to a final Board vote in April. If the OC does not break the project into tranches subjected to annual Board votes, we recommend that Treasury and the USED engage other Executive Directors to send the PBS II project back to the Bank for review before the project is subjected to a Board vote in April.

THE STANCE OF ADDIS-BASED DONORS

13. (SBU) The UK considers PBS critical to its development efforts in Ethiopia. In light of frustration with Ethiopian policy dynamics over the past few years, we understand that the UK Development Minister Douglas Alexander has personally refused to sign on to a multi-year bilateral PBS assistance package, instead restricting aid to annual reviews. The British Embassy in Addis currently opposes subjecting the Bank's PBS II project to a similar annual review mechanism, but it is not clear if this is a local decision or whether London has considered the proposal. Other donors, notably Holland and Ireland, share our concerns that PBS should focus more on enhancing democratic institutions as a way to support economic development. Despite donor concerns over Ethiopia's lack of economic and political reforms, aid continues to flow -- particularly budget support from the EU -- and the GoE continues to expect it.

14. (SBU) To promote policy reforms necessary to render PBS sustainable, Embassy Addis Ababa discussed with donors and World Bank/Ethiopia the idea of breaking the three-year, \$600 million grant-based PBS II project into three, one-year tranches (or at least two tranches reviewed at the mid-point) with each subjected to a new vote by the Bank's Board of Directors which will be predicated on GoE adherence to the pledges of policy action and intent currently made. This one-year tranching approach is consistent with the UK's approach to its bilateral PBS support. The Dutch, Irish, Swedes, and to some extent the Canadians share U.S. concerns about the Bank's program, but without us lack an adequate voice.

NEED ASSURANCES ON MACROECONOMIC BENCHMARKS

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15. (SBU) We recognize that PBS has been essential for the GoE to achieve the huge impacts in recent years toward achieving Millennium Development Goals in health and education. Still, in May 2006, the United States abstained in the World Bank vote on PBS arguing that "the country... [did] not present a sufficiently reliable political and macroeconomic environment to assure sustainability." Two years later, in December 2008, the U.S. noted in another Board vote that Ethiopia had "not yet demonstrated the political will to take on the reforms needed to deliver macroeconomic stability." That December statement further noted that "we also want to make clear to the Bank that future programmatic operations should incorporate commensurate policy commitments aimed at correcting economic distortions in the country, especially in the agricultural sector." While the Bank has received some commitments from the GoE on economic policy commitments, the current project assessment document (PAD) leaves it to the Bank and PBS contributors to determine the appropriateness of continued funding over PBS II's three-year lifespan. Based on our discussions with donors here in Addis, we believe that an internal World Bank review is inadequate and that we need to make continued funding contingent on actual policy progress.

16. (SBU) There has been some movement. Following Bank engagements with the Finance Ministry (MoFED), the GoE has made economic policy pledges to the Bank. The GoE has committed to reduce inflation from 55.3% in June 2008 to 20% and 9% by June 2009 and June 2010 respectively. The GoE has also committed to increasing official reserves from 1.2 months of import coverage as of the end of the 2007/08 fiscal year to 1.8 months and 2.3 months at the end of 2008/09 and 2009/10 respectively. Finally, the GoE has agreed to increase the private sector's share of credit in Ethiopia. While these commitments will help stabilize the economy, such actions are necessary but not sufficient to support the lasting, domestically-based economic growth required to render the PBS gains sustainable. Further, much as was the case in the GoE's Exogenous Shocks Facility loan from the IMF highlighted in reftel, as is, the GoE's pledge is just that -- a pledge -- upon which no specific funding implications are contingent. We acknowledge that the GoE submitted, and has begun taking policy action in line with an economic policy letter to the IMF for this loan, but we remain cautious due to the GoE's refusal to date to accept any binding obligations on economic policy. We believe that by adopting the

UK's one-year tranching approach -- with each year subjected to a Board vote -- we will convey a clear message from the international community that we expect the GoE to follow through on its commitments and meet the targets it has set in its messages of policy intent during the PBS project negotiation process.

CONCERNS LINGER ON SOCIAL MONITORING

17. (SBU) The original roll-out of PBS in 2006 was a political decision in response to political dynamics in Ethiopia following the 2005 elections and most Ethiopia watchers here agree that the project was only adopted because of the robust safeguards put in place to ensure transparency and social monitoring in the so called "component four (C4)" element. The C4 element was a major factor driving the broad donor support for the original PBS grant in 2006, but the final C4 design approved by the GoE was severely watered down from the original intention of providing independent oversight, scrutiny and accountability for the program. Since PBS started there has been further erosion of freedoms at all levels, especially the local level where component four is focused. Within the limits of the planned design there has been some success in the 12 pilots in increasing the ability of local actors to scrutinize the delivery of basic services. However, implementation of C4 has lagged badly, and has been largely implemented through ruling party controlled NGOs and 'member based organizations' (women, youth, peasants) with space for independent NGOs participation remaining limited. In fact, one CSO which was monitoring PBS implementation was even closed down by local authorities (see para 9 below). In addition to these dynamics, the passage of a highly restrictive law (CSO Law) governing NGO activities last month has left many PBS donors and watchers concerned for the viability of C4.

18. (SBU) In response to donor concerns about the impacts of the CSO law on PBS, the Bank elicited a "comfort letter" from the GoE on NGO participation in the (C4)

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element. While the Bank has argued that the letter conveys the intent of the GoE for the CSO law not to affect PBS, we, the Dutch, the Irish, the Swedes, and even some Bank insiders, view vague language in the letter, combined with the GoE's demonstrated actions against NGOs in recent years, as grounds for skepticism. Some see the letter's assurance that the governance structure for C4 implementation will continue "until alternative arrangements are deemed necessary" with particular concern. Another point, noting that "citizens and their organizations are the ones who engage with service providers," has drawn particular Dutch and Irish attention as the CSO Law would render any NGOs receiving more than 10% of their funding from outside sources as "foreign." With the currently vague language, this provision effectively could exclude foreign funded NGOs from C4 activities.

19. (SBU) Although the Bank's staff tells us that the letter's confirmation that PBS funds will count as government resources rather than "foreign" resources for the sake of the 10% rule, NGOs that get more than 10% of their funding from outside, would already be over the "foreign" threshold and may be excluded from participating in PBS. On another point, while one of the main functions for C4 social monitors was to validate impact data presented by local governments, the letter's provision noting that local NGOs will serve merely as "facilitators and in capacity building" fundamentally calls into question the scope of activities which the GoE will actually allow even local NGOs to engage in. During the first PBS project, the GoE restricted international NGOs supporting C4 to "facilitation and capacity building" but local NGOs were very much actively expected to participate. Under the comfort letter's current language, it would appear that the GoE is actually trying to restrict the role of even GoE-defined "local" NGOs in C4.

110. (SBU) While the comfort letter assures the Bank that the GoE will sensitize local authorities on the importance of PBS including its social accountability activities, recent practice also calls this into question. Aggressive GoE training on the new CSO law at the local level attacked NGOs as "rent seekers" and "neo-liberals."

After it was completed, local officials closed down the PBS C4 pilot conducted by an independent NGO in Guraghe Zone (where the opposition was strongly supported in the last election, but all local government posts are held by the ruling party) despite assurances from MoFED that PBS would be insulated from the CSO Law.

COMMENT

¶11. (SBU) The Embassy believes that there must be accountability and assurances that the GoE will honor its economic and C4 social monitoring commitments. The "comfort letters" establish benchmarks, but the current three-year project design lacks an adequate review mechanism. After months of encouraging the Bank's Ethiopia staff to secure economic and C4 assurances from the GoE, our concerns remain on the longer-term sustainability of PBS. These are the same concerns which have forced the United States to abstain on every PBS vote since project inception in early 2006.

¶12. (SBU) Over the past year, international financial institutions have granted or lent Ethiopia over US \$1 billion and questions have been raised on the net impacts of this assistance on the political and economic environment. While Bank staff members concede that recent GoE actions, especially the CSO Law, will cause the Bank to reduce Ethiopia's IDA allocation "at the next review," the Bank remains committed to moving forward in programming the current allocation through PBS. Requiring PBS II to be reviewed by a formal Board vote in three annual tranches (or at least once at the mid-point) will send a clear message to the donor community as well as to the GoE that we take benchmarks seriously and will assess future assistance decisions in light of progress toward achieving them. End Comment.

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